United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

76-4047

Signed

IN THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

FRANKLIN D. COOPER and EVELYN L. COOPER,

Appellants

v.

COMMISSIONER OF INTERNAL REVENUE,

Appellee

ON APPEAL FROM THE DECISION OF THE
UNITED STATES TAX COURT

BRIEF FOR THE APPELLEE

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STATEMENT OF THE ISSUES PRESENTED

1. Whether the Tax Court correctly determined that taxpayer is not entitled to deductions for depreciation of an asset which was neither owned, used, nor possessed by taxpayer during the years in which he took the deductions.

2. Whether the Tax Court correctly upheld the Commissioner's determination that taxpayer was liable under Section 6653(a) of the Internal Revenue Code of 1954 for a penalty for negligent or intentional disregard of the rules and Regulations.

STATEMENT OF THE CASE

This is an appeal by Franklin D. Cooper and Evelyn L. Cooper[1/] from a decision of the United States Tax Court. The Tax Court (Judge Goffe) determined that there are deficiencies in income taxes due from the taxpayer for the years 1971 and 1972 in the amounts of $9,032.72 and $5,078.89, respectively, and additions to tax in the form of penalties for negligent or intentional disregard of the rules and Regulations in the amounts of $451.64 and $253.94 for the same tax years. The Tax Court entered its decision on January 19, 1976, and the taxpayer filed a timely notice of appeal on January 27, 1976. The memorandum findings of fact and opinion of the Tax Court is reported at 34 T.C.M. 320 (1975). Jurisdiction is conferred on this Court by Section 7482. The pertinent facts as found by the Tax Court may be summarized as follows:

Taxpayer is a professional civil engineer and land surveyor who, during the years 1971 and 1972, operated a land surveying business as a sole proprietorship. (Op. 2.)[2/] The business operated on a cash basis method of accounting. (Op. 2.)

1/ Franklin D. Cooper hereinafter is referred to as taxpayer. His wife Evelyn is a party to this action only by reason of having filed joint income tax returns with her husband.

2/ References are to the Tax Court opinion reproduced at Appendix B, infra.

As part of his business taxpayer engaged in aerial photography and aerial surveying. In October of 1971, taxpayer became interested in acquiring for his business a Stereo Comparator manufactured by the Carl Zeiss Company of Oberhochen, Germany. The comparator is a precision instrument which permits aerial photography to be performed in minute detail. Thus, if used with other equipment, extremely accurate aerial surveys can be performed. (Op. 2-3.)

During the periods in question and afterward, taxpayer corresponded with, and talked with, representatives of Zeiss, the manufacturer, and its United States dealer, Keuffel & Esser Company. He was interested in securing delivery of the comparator in 1971, so that he could use the equipment in bidding for certain jobs. In his dealings with Zeiss and with Keuffel & Esser Company, he consistently stressed the need for 1971 delivery. Yet, as a result of delays and disputes, the comparator had not been delivered to the taxpayer as of October, 1975. Nevertheless, taxpayer on February 17, 1972, forwarded a check for $39,000 to Keuffel & Esser, and on later dates sent additional amounts of money to them. By December 4, 1974, taxpayer had deposited with Keuffel & Esser $63,563 of the total $98,481.73 purchase price of the comparator. (Op. 3.)

Taxpayer deducted $30,250 in both 1971 and 1972 for straight line depreciation of the comparator which he had not received.

Taxpayer based this depreciation on a three-year useful life and a cost basis of $90,750. Since taxpayer had neither received the comparator nor put it into use, during the years in which the depreciation was claimed, the Commissioner disallowed the deduction and assessed a penalty against taxpayer for his failure to follow the rules and Regulations. The Tax Court upheld the Commissioner's determination and this appeal followed.

ARGUMENT

I

THE TAX COURT CORRECTLY DETERMINED THAT TAXPAYER WAS NOT ENTITLED TO A DEPRECIATION DEDUCTION FOR PROPERTY WHICH HE DID NOT OWN, HAD NOT RECEIVED, AND HAD NOT PLACED IN SERVICE

Section 167(a) of the Internal Revenue Code of 1954, Appendix A, infra, provides for the allowance of a depreciation deduction for the exhaustion and wear and tear (including a reasonable allowance for obsolescence) of property that is either "used in the [taxpayer's] trade or business" or is "held for the production of income." As the Supreme Court recognized in Massey Motors v. United States, 364 U.S. 92, 96 (1960), depreciable assets generally decrease in utility and value as they are used. Thus, the purpose of the depreciation deduction is to allow taxpayers to recover tax free the total cost of such assets, by permitting them to make meaningful allocations of cost to the tax periods benefited by the use of such assets. Massey Motors, supra, p. 96. Accordingly, the Treasury Regulations (Treasury Regulations on Income Tax (1954 Code), § 1.167(a)-1(a)) provide that the depreciation allowance is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan so that the aggregate of amounts set

aside will at the end of the estimated useful life of the asset, be equal to the cost of the property. See G.W. Van Keppel Co. v. Commissioner, 295 F. 2d 767 (C.A. 8, 1961). Before such depreciation deduction can be taken, however, the "asset * * * [must be] placed in service." Treasury Regulations on Income Tax (1954 Code), § 1.167(a)-10(b) (26 C.F.R.). See also 4 Mertens, Law of Federal Income Taxation, § 23.29.

Taxpayer does not contest the validity of this Regulation. Nevertheless, in 1971 and 1972 he sought a depreciation deduction for a comparator, a piece of machinery which he did not own, had not received, nor put into use. Nor was it available for him to put into use. See Sears Oil Co. v. Commissioner, 359 F. 2d 191, 198 (C.A. 2, 1966) (barge could be depreciated when it became available for use). Indeed, it was not until 1972, that taxpayer, who was a cash basis taxpayer, had deposited any of the funds toward the purchase of the machinery which he sought to depreciate in 1971.

Taxpayer cites no authority permitting him to claim the depreciation deductions in question nor have we been able to find such authority. Indeed, taxpayer's only argument seems to be that because he put aside money to purchase the comparator, he should be entitled to a depreciation deduction even though he did not turn over this money as part of the purchase price until after the first year in which he had claimed a depreciation deduction. To allow taxpayer the deduction he seeks would

permit him a depreciation deduction for property in which he had no economic interest. This result is not changed by taxpayer either putting aside money (as he did through 1971), or by his, in effect, placing a down payment on a piece of machinery in 1972, since taxpayer at no time had the right to use and never did use the comparator. Thus, taxpayer's claimed depreciation deduction was not for the exhaustion, wear and tear, or obsolescence of property used in his trade or business in the years in question.[3/] Since there is no authority in the statute, Regulations or case law, for the depreciation deduction which taxpayer seeks, and since deductions are a matter of legislative grace, Deputy v. du Pont, 308 U.S. 488, 493 (1940), the Tax Court correctly decided that the deduction was properly denied.

II

THE TAX COURT CORRECTLY DETERMINED THAT THE TAXPAYER'S ATTEMPT TO DEPRECIATE PROPERTY WHICH HE NEITHER OWNED NOR PUT INTO USE WAS THE RESULT OF NEGLIGENCE OR INTENTIONAL DISREGARD OF THE RULES AND REGULATIONS

Section 6653(a) of the Internal Revenue Code of 1954, Appendix, infra, provides for an addition to tax when an

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3/ A reasonable allowance for obsolescence is allowed only by reason of taking obsolescence into account when computing an asset's useful life. See Treasury Regulations on Income Tax (1954 Code), § 1.167(a)-9 (26 C.F.R.); Bullock v. Commissioner, 26 T.C. 276 (1956), aff'd per curiam, 253 F. 2d 715 (C.A. 2, 1958). Thus, if taxpayer did not own the property he would not be entitled to a deduction for obsolescence. Moreover, he offered no proof that the comparator would become obsolete.

underpayment of tax is the result of either negligence or the intentional disregard of the rules and Regulations. To avoid having the penalty imposed, one must act as would a reasonable and ordinarily prudent man in similar circumstances. Estate of Lammerts v. Commissioner, 456 F. 2d 681 (C.A. 2, 1972). While the penalty will not be imposed if a taxpayer can show that due care was exercised (10 Mertens, Law of Federal Income Taxation (Rev.), § 55.25), the taxpayer must bear the burden of proving that the Commissioner erred in imposing the penalty. Boynton v. Pedrick, 228 F. 2d 745 (C.A. 2, 1955).

Here taxpayer was a graduate of the Stanford School of Business (Tr. 41) and has taught accounting and engineering economics to engineering students and land suveryors (Tr. 41-42). As the Tax Court recognized (Op. 5), taxpayer's insistence that the acquisition of the comparator be considered a 1971 transaction reflects his knowledge of the tax consequences here at issue. Thus, the taxpayer can hardly be said to have lacked the requisite knowledge that the deductions that he took were improper. Nor indeed does he contest on appeal the imposition of this penalty. Accordingly, the Tax Court's determination that the penalty here was properly imposed should be sustained.

CONCLUSION

For the reasons stated above the decision of the Tax Court should be affirmed.

Respectfully submitted,

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JUNE, 1976.

CERTIFICATE OF SERVICE

It is hereby certified that service of this brief has been made on appellants, appearing pro se, by mailing four copies thereof on this 3rd day of June, 1976, in an envelope, with postage prepaid, properly addressed to him as follows:

Franklin D. Cooper
321 Landsdowne Road
Dewitt, New York 13214

Gilbert E. Andrews per

GILBERT E. ANDREWS,
Attorney.

APPENDIX A

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 167. DEPRECIATION.

(a) General Rule.--There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)--

(1) of property used in the trade or business, or

(2) of property held for the production of income.

* * *

SEC. 6653. FAILURE TO PAY TAX.

(a) Negligence or Intentional Disregard of Rules and Regulations With Respect to Income or Gift Taxes.--If any part of any underpayment (as defined in subsection (c)(1)) of any tax imposed by subtitle A or by chapter 12 of subtitle B (relating to income taxes and gift taxes) is due to negligence or intentional disregard of rules and regulations (but without intent to defraud), there shall be added to the tax an amount equal to 5 percent of the underpayment.

* * *

APPENDIX B

T. C. Memo. 1975-320

UNITED STATES TAX COURT

FRANKLIN D. COOPER AND EVELYN L. COOPER, Petitioners
v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 9211-74 Filed October 29, 1975.

Franklin D. Cooper, pro se.

George W. Connelly, Jr. and Robert Abramitis, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

GOFFE, Judge: The Commissioner determined deficiencies in petitioners' Federal income tax for the taxable years 1971 and 1972 in the amounts of $9,192.03 and $5,176.45, respectively, and additions to tax under the provisions of section 6653(a)[1] for

[1] All Code references are to the Internal Revenue Code of 1954, as amended.

the same years in the amounts of $459.60 and $258.82, respectively. The only adjustment made by the Commissioner in his statutory notice of deficiency is the disallowance in each year of deductions for depreciation of a Zeiss Stereo-Comparator.

FINDINGS OF FACT

Some of the facts have been stipulated. The stipulation of facts and exhibits are incorporated by reference. Only the facts necessary to an understanding of the issue will be summarized here.

Petitioners, husband and wife, filed their joint Federal income tax returns for the taxable years 1971 and 1972 with the Internal Revenue Service Center, Andover, Massachusetts. They resided at DeWitt, New York, when they filed their petition.

Mr. Cooper is a professional civil engineer and licensed land surveyor. During the period involved here, he operated as a sole proprietor a business of land surveying which included aerial photography and aerial surveying. The business is on the cash basis of accounting.

In October 1971, Mr. Cooper became interested in acquiring for his business a Carl Zeiss Stereo-Comparator, manufactured by Carl Zeiss Co. of Oberhochen,

Germany. The comparator is an extraordinary precision instrument which will permit aerial photography in minute detail. Its use with other equipment can produce aerial surveys of extreme accuracy. Mr. Cooper corresponded with and talked with representatives of Zeiss and its United States dealer, Keuffel & Esser Co. He was interested in securing delivery in 1971 in order to use the equipment for bidding jobs that were open and consistently stressed the need for delivery in 1971. Because of delays and disputes, the comparator has not been delivered to Mr. Cooper. Nevertheless, on February 17, 1972, Mr. Cooper forwarded a check for $39,000 to Keuffel & Esser and sent additional funds at later dates. By December 4, 1974, Mr. Cooper had deposited $63,563 with Keuffel & Esser. The total purchase price was $98,481.73.

On their joint income tax returns for 1971 and 1972, petitioners claimed straight line depreciation of $30,250 each year on the Zeiss Stereo-Comparator PSK 2 based upon a 3-year useful life and a cost basis of $90,750. The Commissioner disallowed the deduction claimed for each year because the comparator was neither in petitioners' possession nor placed in service by petitioners during the taxable years in which depreciation was claimed.

OPINION

Petitioners claimed depreciation deductions on their returns for 1971 and 1972 for equipment to be used in their sole proprietorship which was not in their possession nor paid for during those years. Petitioners claim that the deduction is for obsolescence rather than depreciation and that if the equipment had been delivered as promised by the manufacturer and its United States representative it could have been used in petitioners' business.

We are sympathetic with petitioners' plight but petitioners are clearly not entitled to the deductions for depreciation. Section 1.167(a)-10(b), Income Tax Regs., provides that the period for which depreciation may be claimed commences when the depreciable asset is placed in service. Mr. Cooper did not, in 1971 or 1972, place the comparator in service; therefore, petitioners are not entitled to the deductions they claimed for depreciation. Obsolescence, which petitioners claim applies here, is part of the depreciation allowance. Sec. 1.167(a)-9, Income Tax Regs.

The Commissioner determined that petitioners were liable under section 6653(a) for the penalty for negligent or intentional disregard of the rules and

regulations. The burden of proof is upon petitioners to prove that the penalty was imposed in error. See, e.g., David Courtney, 28 T.C. 658, 669-670 (1957). An examination of the voluminous correspondence from Mr. Cooper to Zeiss and Keuffel & Esser reflects Mr. Cooper's concern that the acquisition of the comparator be a 1971 transaction. The knowledge that necessarily accompanies Mr. Cooper's insistence that the transaction must be a 1971 transaction convinces us that the penalty was not imposed in error.

In order to allow a concession of the respondent as to the deductions for state sales tax,

Decision will be entered under Rule 155.